International Financ

A crisis of confidence in international lending is curtailing the flow of capital to less developed countries (LDCs). At a minimum many LDCs will have to make strenuous economic adjustments. At worst these required adjustments may be so severe as to disrupt economic activity and spur a political backlash against Western governments and financial institutions.

For the first time, most of the handful of LDCs that account for the bulk of the group's borrowing from foreign banks either cannot or are in the immiment danger of being unable to meet their debt service obligations. LDCs have been hit hard by the lengthy industrial country economic recession and high real interest rates. Some oil exporters--Mexico, Venezuela, Nigeria, and Ecuador--face serious financial difficulties because of inability to adjust their profligate spending habits to the new oil market realities. The plight of others, especially Argentina, has been made worse by political instability and economic mismanagement. Under the best of circumstances, it will take many LDCs at least two years, and in the case of Mexico and Argentina probably longer, to regain a strong enough foreign financial position to allow sustained economic growth.

Events in Argentina and Mexico have transformed the debt problem from one that could be treated purely as reflecting deficiencies of policies and management in a few countries to one that involves the health of the entire international financial system and the performance of the world economy. Bankers are curtailing loans to countries like Brazil not just because their assessment of Brazil's domestic policies has turned negative, but also because they are extremely nervous about a high degree of exposure in the present world environment. They are carefully watching their exposure not only to problem countries, but to all of Latin America, and even to LDCs as a group.

The decline in the net inflow of bank lending, on top of a substantial drop in export earnings, is forcing LDCs to substantially curtail imports. The needed import cuts will be especially large in Mexico and Brazil, countries which have close trade links with the United States. LDC import cuts will be accompanied by reductions in incomes and economic activity, which will entail painful political decisions and conflicts. The economies of the industrial nations also will be adversely affected, as is already occurring in the United States as a result of the severe problems in Mexico.